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DEPT FOR AF/E AND AF/EPS
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TAGS: ECON ETRD KIPR KE CH
SUBJECT: Kenya and China: Stronger Economic Ties Driven by Growing
Chinese Exports to Kenya

Refs: A. 06 Nairobi 5374, B. 05 Nairobi 3600

NAIROBI 00000075 001.2 OF 003

¶1. (SBU) Summary: Economic ties between Kenya and China are growing stronger, a trend being driven primarily by greater bilateral trade and, more precisely, by a rapid increase in Chinese exports to Kenya. While trade with China is increasingly important to Kenya, it still accounts for only 3% of total trade, a share dwarfed by Kenya's trade with the rest of Africa, the EU, and even the United States. The trade relationship is overwhelmingly in China's favor, and inherent structural weaknesses in Kenya's economy make it unlikely Kenya will ever be capable of closing the gap. For the moment at least, the continuing surge in Chinese imports into Kenya is benefiting consumers, without major damage yet to the country's manufacturing sector. However, Kenya's apparel industry is threatened globally by Chinese competition, and anyone competing with Chinese-made knock-offs is also having a hard time. End summary.

¶2. (U) This cable updates ref B's analysis of the burgeoning economic relationship between Kenya and the Peoples Republic of China (PRC), with an emphasis on the trade relationship. Septel(s) will touch on other aspects of the economic relationship, put it into a broader political perspective, and examine how it impacts U.S. interests in Kenya and in East Africa.

It's All About Trade, and Trade is Growing

¶3. (SBU) In public remarks at the November 8 launch in Nairobi of the World Bank publication "The Silk Road: China and India's New Frontier," Mukhisa Kituyi, Kenya's Minister for Trade and Industry, said that the story of China's recent economic penetration into Africa is "overwhelmingly about the expansion of Chinese exports" to the continent. This is certainly the case for Kenya.

¶4. (U) According to the same Government of Kenya (GOK) dataset used in ref B, total two-way trade between Kenya and the PRC expanded by 53.5% in 2005 to a total of $300 million. This followed a 60% increase in bilateral trade in 2004, and a near 33% increase in

¶2003. (Note: GOK trade data for 2006 will not be available for several months. End note). This growth outpaced the 16.5% overall growth rate for Kenya's total external trade in 2005. In further contrast, Kenya's trade with the rest of Africa grew 17.8% in 2006, but by only 8.1% with the EU. Bilateral Kenya-U.S. trade increased by a walloping 148%, but this should be seen as an aberration caused by the delivery in 2005 of big-ticket Boeing aircraft to Kenya. (Note: Additional Boeing deliveries may also skew trade trends greatly in the U.S. favor in 2006 and 2007. End note).

Chinese Share Small - But Growing

¶5. (SBU) Perspective is in order, however. Kenya's trade with China still accounts for only 3.1% of its total trade with the rest of the world. In comparison, the rest of Africa accounted for 27% of everything Kenya bought and sold globally in 2005. The EU accounted for another 23%, and the United States 6.9%. But in light of the strong year-to-year growth rates in Kenya-PRC trade, China's share of Kenya's total trade pie is steadily growing: from 1.5% in 2002, to 1.8% in 2003, 2.4% in 2004, and 3.1% in 2005.

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Trade Relationship A Two-Edged Sword for Kenya
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¶6. (SBU) For Kenya, greater trade with China is a two-edged sword. True to the remarks of Trade Minister Kituyi, the balance of trade remains overwhelmingly in China's favor: Kenya's exports to the PRC totaled just $18.1 million in 2005; Chinese exports to Kenya were more than six times greater at $283 million. Although Kenya's exports to China are growing (up 40% in 2005), Chinese imports into Kenya are growing faster, and off of a larger base. Moreover, there are hard constraints on expansion of Kenyan exports to China. Indeed, absent future oil or gas discoveries and exports, there is

little hope that Kenya can ever come close to meaningfully narrowing its large trade deficit with China.

¶7. (SBU) First, Kenya, like countries everywhere, has found the Chinese market less than fully open. In his November 8 remarks, Trade Minister Kituyi complained that "China is a very difficult place to export agricultural products to", despite the recent expansion by the PRC government of the list of products from Africa granted duty-free import into China. But, second, Kituyi acknowledged that the problem also lies with Kenya, which like most African countries, lacks "supply elasticity." These "supply capacity problems" render Kenya's small producer market unable to rapidly ramp up production and exports to exploit a surge in demand from China (or elsewhere for that matter) for any given product. When a nation's companies are relatively small, overseas market share is hard to win, and hard to keep.

¶8. (SBU) In a similar vein, Kenyan trading firms are mostly small-scale and are hobbled by the geographic, cultural, and linguistic distances between the two countries. They simply lack the financial wherewithal and sophistication to successfully tap into a market as large, as complex, as competitive, and as distant as China's. On top of this, they have relatively little to sell to a rapidly industrializing China. At the moment, Kenya's exports are primarily raw materials and agricultural products (nuts, hides, skins, fiber, tea, and coffee). Value-added agro-processing holds some potential for increased Kenyan exports to China. Another potentially major boost could come with greater tourist flows from China to Kenya. But the same factors that undermine Kenya's competitiveness in all other regional and overseas markets make it all the more difficult to compete with or in China. These include the usual deep-seated culprits: corruption/poor governance, decrepit and expensive infrastructure, costly and unreliable power, insecurity, and excessive government red tape. Even growth in the tourist sector is constrained at the moment by poor roads and limited capacity.

But Does it Matter?

¶9. (SBU) No definitive studies have been done yet on the impact of the China-Kenya trade imbalance on Kenya's economy, and given the relatively small share of total Kenyan imports that come from China (4.6%), such an investigation might not yield firm conclusions. Trade Minister Kituyi claimed on November 8 that Chinese imports are not adversely affecting Kenyan producers at this time, but are instead displacing traditional third country suppliers. Where Kenya once bought motorcycles from Japan, it is now doing so from China, for example. In this way, argued Kituyi, countries like Kenya are benefiting from the surge in Chinese imports because they are pushing down consumer prices for goods of comparable quality.

¶10. (SBU) This tune is beginning to change, particularly in light of the surge in "substandard" (read "counterfeit") products entering Kenya and the rest of the region, primarily from China and South Asia. As noted ref A, while estimates vary, the GOK believes Kenyan companies lose between $850 million and $1.1 billion per year to counterfeit goods - no small change for an economy of Kenya's size.

¶11. (SBU) The recently-established American Chamber of Commerce in Kenya has made IPR protection and combating counterfeit products its highest priority, and Minister Kituyi himself appears increasingly aware of the damage that counterfeiting is causing to Kenya's investment climate and economy. A number of multinational operations in Kenya have apparently finally convinced him and others in the GOK that they will scale down their operations or pull out of Kenya altogether if nothing is done to stop the onslaught of Chinese and other country fakes. As reported ref A, Kenyan authorities seized and destroyed a large shipment of counterfeited Bic pens from China in December. The fakes incorporated a credible forgery of the GOK's own quality mark meant to prevent counterfeiting. Kituyi and others were incensed and have vowed to tighten inspections of imports. Counterpart GOK and PRC authorities also signed an agreement in October under which the PRC undertook to improve pre-shipment checks on goods being exported to Kenya. It is unclear

whether the agreement has had any impact on stemming the flow of counterfeits coming into Kenya.

Will Chinese Imports Kill Manufacturing?

¶12. (SBU) Ultimately, even in the theoretical absence of cheap counterfeit competition, it seems logical that Chinese exports to Kenya will harm indigenous Kenyan industry. As noted ref B, Chinese apparel exports have to some extent displaced Kenyan products in the U.S. and other markets following the expiration of quotas under the Multi-Fiber Arrangement at the end of 2005. With this loss of market share, Kenya has lost between 5,000 and 10,000 of the jobs created after the apparel industry sprang to life following passage of the Africa Growth and Opportunity Act (AGOA) by the U.S. in 2000.

¶13. (SBU) But the evidence otherwise is inconclusive. At home, there is grumbling on the streets about aggressive Chinese traders undercutting Kenyan merchants. For now, however, public opinion continues to see the increasing availability of Chinese goods as on balance a good thing because it makes more products available at lower prices to more consumers than would otherwise be the case. Moreover, apart from apparel, for the moment there is no evidence that Kenya's manufacturing sector is under any serious or broad threat from Chinese imports per se. The sector, nascent by developed country standards, is relatively advanced and diversified in the regional context. It accounted for 11% of Kenya's GDP and grew by 5.0% in 2005. This was better than 2004's growth of 4.5%, but lower than the overall GDP growth rate in 2005 of 5.8%.
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